PROBLEMS OF COOPERATIVE ORGANIZATIONS

Prepared by
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Senior Extension Economist

for

Cooperative Short Course, Held at Lake Carl Blackwell,
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It has been said of the cooperative method of doing business that cooperation is a combination of the practical and ideal. In these lessons on "Problems of Cooperative Organizations" the practical side of cooperation will be stressed. Anyone, who is interested in cooperation as applied to business endeavors, should realize that cooperatives are business institutions, and that the same yardstick must be used in measuring their success as is applied to private businesses, partnerships, or corporate enterprises. In order to succeed, cooperatives must be operated under the same sound business policies as other types of businesses, because they face the same problems as those common to general business. Under no circumstances can these problems be solved by wishful thinking or by the application of ideology in the absence of practical policies and business-like approaches.

Let us consider, therefore, during this series of lessons, some of the more common problems which confront cooperatives, and the practical approaches to their solution. For the sake of convenience and for purposes of discussion, we shall attempt to classify these problems into five categories; (1) Organization problems; (2) management problems; (3) membership-relations problems; (4) financial problems; and (5) operative problems.

Organization Problems

The problems resulting from organization have been of great concern to cooperatives in the past, and they still persist. Too often groups of farmers, upon finding themselves in difficulty, have concluded, or have been led to believe, that a cooperative organization would solve all of their troubles, regardless of their kind or cause.

Organizers and professional promotors have been partly responsible for this attitude and many times have painted "beautiful pictures" of the possibilities of a cooperative which, to the farmers, represented "sunrise" but which proved later to be nothing more than "sunset."

Experiences of this kind have taught us to withhold the expression of too much enthusiasm concerning the possibilities of a successful cooperative until sufficient information has been collected and sound consideration has been given to the problems to be solved.

Does economic need exist?

The first step to take, in approaching the possibilities of organizing a cooperative association, should be to determine whether there is an economic need for such an institution in a community. This can best be done by conducting a fact-finding survey, which will help to answer many of the questions in the minds of those farmers who are interested in organizing a new cooperative association. Such a survey should be complete from the standpoint of getting all of the information needed and should be made on a formal basis if it is to be of most benefit. In preparation for making the survey, a committee should be appointed to work and advise with Extension personnel, and with representatives of other agencies who are familiar with this procedure and with the problems to be considered.

Chances for success or failure

It is also a good plan to review the record of comparable cooperatives in other localities, where similar conditions exist, and to determine the reasons for their failure or success. If a similar cooperative has already been tried in your community, it is important to learn why it did not continue to function. Furthermore, the attitude of the membership toward their cooperatives in other communities should be noted, as well as information relative to the success of their cooperatives. The information, thus obtained, should be discussed thoroughly with all of those who are interested in the organization of a new cooperative. This should help farmers to determine and crystallize the problems which they are facing. It should also help them to determine whether a cooperative can or cannot function as the agency to solve their problems.

Three causes for economic need

As already implied, it is doubtful if any cooperative can succeed for any considerable length of time unless a definite economic need for it exists. If the results of the survey conclusively prove that there is a definite economic need for the new cooperative, generally that need will be implemented by one of three causes.

First, the need may be for increased net returns to farmers for their products through providing necessary services at lower costs. This means that the cooperative must get the necessary volume of business to insure low operating costs, adequate operating margins, and a possibility of building up reserves, making adequate returns to producers and, at the same time, meeting competition.

The second possible need may be that of correcting unsatisfactory trade practices. Experience shows that in many cases farmers have been subjected to unfair trade policies, including inaccurate tests and weights, inefficient

handling, and misrepresentation of grade and quality. These practices, in some instances, have been costly.

The third need, which farmers have many times found that a cooperative institution will help in fulfilling, is that of improving the quality of the products marketed, or of improving the marketing methods in effect. This often calls for the improvement of some of the marketing functions, such as processing, packaging, and grading of products to improve consumer demand. On the other hand, it is often found necessary to improve the selling methods and practices themselves. All of these problems and needs can be corrected and fulfilled through cooperation, provided the proper set-up is had, the correct procedures are followed, and the needs for the organization are generally recognized by farmers who are potential members of the new association.

Organization committee is important

After it has been determined that there is a definite economic need for a new cooperative organization, the next step in the procedure is that of appointing an organization committee. This committee should consist of the keenest men in the community, who are directly interested in organizing a cooperative association and who are willing to give much of their time and effort in order to insure its success. It is the job of the organization committee, with the help of Extension personnel or other informed persons who know the proper legal procedure and practical problems of organization, to draw up articles of incorporation, bylaws, and a marketing agreement or contract. In drawing up these documents, care should be taken to fulfill all of the requirements of the Capper-Volstead Act and of State cooperative laws.

To qualify as a cooperative under this Federal legislation and to enjoy the privileges which are extended to all true cooperatives, one man should have but one vote in organization and control or else no more than 8 percent

interest shall be paid on the stock of cooperative organizations. In addition, at least 50 percent of the business of the cooperative must be done with members.

Members should finance cooperative

The organization committee will be faced with the problem of determining whether the new association shall be a stock type of organization, or whether the necessary finances shall be raised through membership dues. It will suffice here to say that from a financial standpoint it makes little difference whether an association is incorporated with or without capital stock. As will be shown later, the important thing to consider is that of raising sufficient capital from the members to properly finance the new association.

Incorporation limits liabilities

After the cooperative has been organized and is ready to start operations, the next consideration should be that of incorporation. Many of the cooperatives that have been organized in the past have never been incorporated. This, very likely, is because the need for such procedure was not recognized by the farmers at the time of organization. However, this is important from a legal standpoint because it limits the liabilities, financial or otherwise, to the association itself rather than to the members, board of directors, or manager as individuals. The process of incorporation costs little and means much to members when they understand that they individually are not financially liable for any activities in which their incorporated association may engage.

Plan growth as business warrants

By following the procedure outlined above and by remembering that it is always better to start a new association in a relatively small way and

grow, rather than be overexpanded at the beginning and top-heavy with investments which are not necessary, we are well on the way of establishing a successful cooperative organization. Furthermore, we shall not have the worries that result from overselling the possibilities of the new association which will eventually result in undesirable reactions on the part of the membership and in their failure to support it.

Cooperative is no cure-all

It is always well to keep in mind that there are some things that a cooperative can do and do well, while there are others that a cooperative never has been able to accomplish and probably never will. The things that a cooperative cannot do may be summarized by saying that they cannot eliminate necessary functions which are performed by middlemen, and they cannot perform miracles or serve as a cure-all for farmers, regardless of what may ail them. They must follow good business practices to succeed.

Finally, regardless of all the propaganda which has been spread in the past, cooperatives cannot fix prices indiscriminately for the products which farmers have to sell. This is impossible, for in order to do so it would be necessary to have monopolistic control over the production of each agricultural commodity and its substitutes. This is not only impossible but it is impractical, since it would prove to be detrimental to the general welfare.

Cooperative accomplishments

Therefore, let us emphasize those things which cooperatives can do successfully, as has been proven by past experiences. Among these is the fact that cooperatives can often succeed in lowering the costs of marketing services and thereby increase the returns to producers. They can help in teaching growers how to produce more in accordance with market demand. They have helped greatly in bringing about orderly marketing of agricultural products

and, for some commodities, have performed the function of collective bargaining. They have taken out part of the speculation or gamble in selling methods and, generally speaking, have followed the policy of making returns to farmers in accordance with the quality of the products delivered to the association. Finally, we should not overlook the fact that, in many instances, the organization and operation of cooperative associations has contributed greatly to a finer rural civilization.

We have considered some of the more important problems in connection with cooperative organization work. Many others, just as important, are yet to be taken up. These have to do with the member relationships to their association, the consideration of the qualifications and responsibilities of the board of directors and manager, the determination and application of sound operative policies, and the necessity of providing satisfactory financial equipment for the association. These considerations will be taken up in succeeding lessons.

Problems in Membership Relations

One of the most difficult problems which cooperatives face is that of membership relations. For numerous reasons, members sometimes do not seem to feel that they have a responsibility to their cooperative and therefore are very lax in giving it their support. In other words, they are disloyal to their association which has been set up to serve them, and many times look upon it as just another sales outlet.

Lack of interest makes for failure

When such thinking and action becomes predominant among the members of a cooperative, that organization is well along the road to failure. The only correction for such a situation is an educational and informational program which will develop understanding on the part of members regarding the

pertinent facts and objectives of their association. It is much better and easier, however, to prevent the occurence of such a condition than to correct it after much damage to the association has resulted.

Mutual understanding promotes success

It is not only desirable but necessary in a cooperative organization to have close and friendly relations, based on mutual understanding between the management and the members. Members should understand the functions of their cooperative, both from the standpoint of business administration and membership administration. Business administration, of course, includes such considerations as financing, processing, merchandising, supervision, the extension of credit, and collections; whereas membership administration is no more or less than maintaining agreeable human relations.

Members should be taught to understand that the cooperative is their organization and that it is owned and operated by them and for them. Such understanding of ownership goes far in generating pride and interest on the part of members, and helps to insure the operations and success of their association. Furthermore, it is also necessary to have a working relationship between the membership and management of a cooperative, such as outlined, to insure that members will "stand by" their cooperative during periods of adversity.

Full information inspires loyalty

A thoroughly informed member is generally a loyal member, while an uninformed or partly informed member is sometimes easy prey for an enemy of the association who may tell the story of the association's activities through the use of half truths. It should be obvious, therefore, why it is necessary for the management and the board of directors of any cooperative association to spend a good deal of time in adequately informing the members of the progress, status and the general program of their association.

Keep membership contacts continuous

Cooperatives have devised numerous methods and ways of keeping their members informed, but not all officials of cooperative organizations have yet learned that an educational information program should be continuous. Current information regarding their association should be passed on to members continuously after the first heat and excitement of the organization period has passed away.

Some cooperatives have sought to supply this very important service to members by preparing a brief statement concerning specific points of interest regarding the activities of the association, and enclosing it along with the checks or other materials which are mailed to members each month. Other and more prosperous cooperatives have seen fit to go to the expense of publishing an official current periodical which is mailed to the members from time to time. Still others have leaned heavily upon mimeographed letters to keep their members informed or have used radio programs extensively for this purpose.

Employees can help in program

Perhaps the most common method of keeping membership informed regarding the activities of their association is that of word of mouth. A number of cooperatives, which use this method to best advantage, have taken the trouble to adequately inform their field service men, truck drivers, and other employees regarding association affairs so that they may keep the members informed. Others have established local representatives throughout the territory and some have even established advisory councils for this purpose. Always, the manager and the board of directors are expected to do whatever they can to keep their membership informed and satisfied.

Regardless of the method used, it should be remembered that no method will do the job unless it is used regularly and conscientiously. Furthermore, it should be remembered in this connection that special emphasis should

be given to informing new members of the objectives, methods of operation, problems ahead, and methods of attack in order to give them a real grasp of the activities and usefulness of their organization.

Adequate financing essential

When a thorough-going, continuous educational program is conducted by a cooperative organization, it is much easier for the members to understand and accept their responsibilities to their organization. Soon they will learn that they have a very definite obligation to their association from the standpoint of adequately financing it in order that it may function more effectively and efficiently and be able to secure returns for them in keeping with the quality of products which they deliver to their association. Of course, they will recognize that the finances can be raised either by investing their own funds in the association or by meeting a large part of their financial needs through a credit agency. As previously mentioned, however, the membership owns the cooperative in the fullest sense only if the membership itself, at least ultimately, provides all the necessary capital for operations of the association. Furthermore, the members will also appreciate that if they do not deliver their products to the association the volume of business will fall off which will cause innumerable operating problems for the management, higher per unit costs of operation, and smaller returns to members.

Members responsible for choice of directors

Another responsibility which the membership must come to understand is that the members themselves must choose the men who are to serve on the board of directors. This is an important obligation, as will be shown later, and can only be accomplished by the members showing sufficient and active interest in attending the annual meeting, at which time new members of the board of directors will be selected. By so doing, and by other means, the members

express their interest and insistence that the association be operated on a sound and satisfactory basis.

Marketing agreement determines responsibilities

Perhaps one of the best methods to definitely point out the responsibilities of the membership to the association and the association to the membership is that of a marketing agreement. A membership marketing agreement is sometimes looked upon by uninformed members as an instrument which binds them for a certain period of time to the association. It is true that this is one of the functions of a marketing agreement, but this should be looked upon and considered as secondary in importance to that of its specific statement of the relationships and responsibilities of all parties that are concerned in the welfare of the association.

Perhaps enough has been said to point out that one of the most important needs of any cooperative organization is that of a well-informed, active membership. This does not mean that only a small percentage of the membership should be well informed but all those who patronize the cooperative. Members as well as nonmembers, should be kept in touch with the affairs of the association.

Keep voting control active

Care should be taken to insure that the active members actually hold the voting control of the association. This sometimes necessitates revising the membership and ownership of the association which preferably should include only active members who continually patronize the association. Some associations in the past have overlooked this important principle and, years after the period of organization, have discovered that practically all of their stock was in the hands of retired farmers or farmers who had otherwise become inactive. To correct such a situation requires a major operation. It is much better and easier to constantly revise the membership from year to year in

order to prevent such an occurrence.

Problems in Management

The very important consideration is sometimes overlooked, that there is no substitute for good management in any business, and cooperatives are no exception to the rule. Some members of cooperative organizations seem to think that the association should be able to run itself. This is a serious mistake that can only be corrected by supplying the proper type of management. Since the board of directors is the real management of any cooperative association, whose responsibility it is to decide upon and lay out the operating policies of the association, and then see to it that they are enforced, let us briefly consider the functions and qualifications of the directors before we think in terms of the manager himself.

Perhaps it would be well to repeat that it is the duty of members to elect to the board of directors properly qualified men who have good business judgment and ability to do the job properly. The best farmers in the community should be given careful consideration by the members of the association in making their selection of directors.

Directors' duties are important

Since it is the responsibility of the board of directors to determine and lay out the policies of the association and to see to it that their policies are carried out by the manager, it becomes obvious that their duties are more than that of attending the monthly board meeting, listening to the reports of the manager and always accepting his views, and then passing a resolution for adjournment. The board members should make it their personal responsibility to represent the interests of the members and to direct the activities of the association for their maximum welfare. This they can best do by keeping informed of the attitude of patrons and members and by serving

as a connecting link between them and the management. They should never forget that the members are the ones who really own and control the association and that the board of directors only serves the function of representing the members. It follows, therefore, that they should keep the members informed as to membership responsibilities and duties and as to ownership, so that the members may give intelligent support and constructive criticism to their organization.

Directors oversee manager

Another responsibility which the board of directors has to the membership is that of requiring regular reports from the manager, and of asking questions about and really understanding the business. The directors should make it a point to visit the plant to see the plant in operation and to visit with the manager and the help. They should carefully analyze and consider the regular audit and reports of the manager, and fully weigh his recommendations before acting thereon. Regarding proposed changes in policies of operation and expansion, they should vote according to their individual convictions. It might be well to add, however, that once a vote has been taken and a policy decided upon by the majority, it is also the duty of those members of the board, who are in the minority, to support an adopted policy, whether or not they are in full agreement with the views of the majority.

Financial budget serves as guide

It goes without saying that the planning and handling of the financial affairs of the association should be one of the chief concerns of all boards of directors of cooperative associations. In many instances, it has been proven that one of the best methods of handling the financial affairs of a cooperative is by operating according to an established budget. If this is done, the board should approve the budget of the manager and review it from time to time to see that he is operating within its limitations. Furthermore,

this method of procedure will help to guide the directors in spending the association's money as carefully as they would spend their own.

In selecting a manager and other employees to carry out the policies and judgment of the board, directors should give consideration to the responsibilities involved and the training required for the positions to be filled. These factors should be given consideration before it is determined what salaries and wages will be paid.

Choose manager strictly on ability

Experience shows that it is a common failing on the part of farmer directors to feel that they should be able to get an excellent manager to conduct the affairs of the association at a very nominal figure. They somehow fail to realize that, in order for the association to be successful, their manager must be as skillful an operator as the managers employed by their competitors. Consequently, when they hire, for example, a $1500 a year man to do the job which requires the training and experience of a man who is capable of demanding $3000 or $4000 a year for his services, they immediately put themselves and the entire membership under a great handicap. This should be taken to mean that the employment of a man as manager for a cooperative organization should be on a strictly business basis, and friendships and relatives of the board of directors as such should be given little consideration. Seldom, if ever, should a board of directors employ their own relatives to serve either in the plant or in the office of a cooperative, and, if such are employed, the directors, instead of listening to their criticisms, should insist upon their loyalty to the management and the association.

No salaries for directors

Naturally, the directors themselves should not be on the payroll of their own association because they have been elected to their positions for the purpose of serving the entire membership to the best of their abilities.

Experiences have shown that when a director is also on the pay roll of his association, many times personal desires and interests outweigh his membership interests and, if so, he is no longer qualified to properly do the job to which he has been elected.

Manager carries out orders of the board

In considering the responsibilities and duties of the manager, it is well to remember that he is the "main spring" of the association, whose job it is to see that the directors' policies are effected and that the association operates smoothly and efficiently. He is the hired employee of the board of directors, which in turn represents the interests of the membership. The manager should be experienced in the particular line of business in which the cooperative is engaged, and he should look upon it as part of his duty to secure the assistance of the board of directors on all major problems, and then follow their advice and recommendations. Furthermore, he should consider it his duty to devise ways and means of putting into effect the policies decided upon by the board, and should consider his reports to them to be a personal responsibility rather than a necessary evil. This, of course, means that the manager should be willing to prepare comprehensive reports, concerning the status of operations in the cooperative, whenever there is a need for such reports so that they may serve as a basis for the consideration of future policies and recommendations of the board of directors.

Keeps posted on membership needs

Another important function of the manager should be that of developing satisfactory membership relations. Some managers seem to feel that there is no difference between operating a cooperative association and any private enterprise and, therefore, ignore the membership and their place in the association. This is, of course, an entirely erroneous assumption and, unless the manager is able to change his viewpoint in this regard and wholeheartedly

develops a program to keep the membership informed, seeks their advice, and listens to their criticisms in the hope of doing a more effective job of management, perhaps the board would do well to look for a new manager to take charge of the association's activities.

Trains managerial understudies

Finally, one other duty of the manager which should not be overlooked is that of training understudies who can take his place in case of his absence or incapacity to hold his position. In the absence of such training, boards of directors many times find themselves in the position of needing a new manager immediately and are at a loss to know where to turn to get one. Under situations of this kind, they sometimes follow the easy way out by employing some "bright young man" in the community to do the job with the hope and expectation that he will learn the business in time. This procedure has proven to be a costly experiment for a number of cooperatives.

In this connection, we should not overlook one of the real purposes of holding this cooperative short course here in Oklahoma, namely, that of instructing a chosen group of you young people in the State to better understand the purposes, objectives, and functions of the cooperative method of doing business, in order that, perhaps a little later, cooperative associations in the State will be in a position to secure your assistance in furthering the cooperative program in Oklahoma.

Problems in Cooperative Financing

Under-capitalization, with resulting financial problems, has bothered many cooperatives since they were first organized. This difficulty generally grows out of the fact that those interested in organizing the new association either underestimated the amount of capital necessary to adequately finance their operations or labored under the false impression that additional

capital could be raised as needed. Invariably, they later learned that it is much easier to raise the necessary capital before the association begins to operate than it is to wait until after operations begin and then endeavor to sell additional memberships or capital stock in the association to prospective members. Consequently, in many instances, cooperatives have continued to try to function with too little capital which handicaps them at every "turn of the road."

Retain ownership and control by active members

As stated earlier, every member of the cooperative association should have enough of his own money invested in the association to have a definite feeling of ownership and to feel obliged to do what he can to insure the success of his association. By so doing, he later learns that his business needs are usually best served by the organization which he is helping to finance.

It has also been suggested that it is necessary to keep the ownership and control of a cooperative with the patron members. This necessitates a change in ownership from time to time in order to retire the interests of members in the association who are no longer active.

Revolving fund provides capital

This is best accomplished by a method that has come to be known as the "revolving capital plan of financing," and is being adopted by more and more cooperatives as time goes on. If this type of financing is to be used, however, the purpose of the retains to be withheld from the membership returns must be specified in the bylaws and marketing agreement of the association. Thus, the financial program of the association will provide for specific retains to be withheld from each producer, based upon the volume of business done by the individual producer through the association.

Need sufficient sum for business

The retains withheld should be a sum sufficient for financing both the current operations and the fixed assets of the association. Bylaws and marketing agreements are sometimes drawn to authorize deductions to pay operating and other expenses, but do not authorize deductions for the purposes of fixed assets. This is a mistake which should be corrected in order to permit active members of the association to eventually entirely finance and own their organization. The financial program should provide for a continuance of the retain after adequate capital is provided, thereby permitting those who made the earlier contributions to have such contributions returned to them by revolving the capital.

Take revolving capital from sale proceeds

Perhaps it may be well to analyze just a bit more in detail how this revolving capital plan works through the retain system. After the initial capital is raised and a cooperative has begun to function, it deducts a certain amount per unit from the sales proceeds of each unit of commodity handled for the member, and this deduction is added to the capital. It should be remembered that this retain is taken out for capital purposes only and should not be confused with amounts deducted to pay operating expenses or to add to the capital reserves.

The capital deductions are credited to the accounts of the members and, at the end of the year's operations a certificate, for the total amount of the deductions, which the cooperative has made for capital purposes during the year, is issued to the member or a ledger account is set up in favor of the member to account for the retains deducted.

No due date on certificates

If certificates are issued to give evidence of the retains, they should be issued without a due date or a fixed dividend provision. Although the pay-

ment of dividends or interest encourages the members to regard the capital retain as an investment or savings account, the payments of dividends or interest on this capital should be left entirely to the discretion of the board of directors. Furthermore, the membership equity, as represented by certificates or other evidence of ownership, should be callable by the board of directors at their discretion. The financial condition of the association should be the major factor to be considered by the board of directors in determining whether or not the association is in a position to revolve the capital.

Revolving the capital

After a cooperative has accumulated sufficient capital for its needs, then, at the discretion of the board of directors, the capital is revolved; that is, each year a number of certificates are called for redemption. Generally, the oldest outstanding certificates or credits are retired first. The capital thus retired is replaced by continuing the retain deductions, and the amount of capital refunded each year depends upon the financial position of the cooperative, its needs for additional capital, and the amount of capital contributed during the current season.

Advantages of the plan

Some very definite advantages result from the revolving capital plan of financing. Such a plan provides a practical way to capitalize the association and, at the same time, to keep the ownership and control of the cooperative in the hands of the active membership. It has the advantage that the members finance the association in proportion to the use they make of it, and it provides an equitable procedure for repaying the investments which have been made by the retired or deceased members.

Guides to Borrowing

If such a system of financing is put into effect by the board of directors and kept working, the association is virtually assured of adequate capital to meet its financial obligations. If an association has enough owned current assets, it should be able to liquidate all its current borrowings at least once a year and still be able to maintain a favorable ratio of current assets to current liabilities.

Ordinarily, the peak of borrowings of any association, for any other than fixed assets, should not increase the current liabilities to a point where they are more than four times greater than the difference of the current assets over the current liabilities, providing the borrowings are secured by pledged collateral covering the commodities handled. If the current borrowings are not secured by the pledging of commodities handled, the current liabilities at the peak of borrowing should not be more than twice as much as the difference of the current assets over the current liabilities. If the current position of the association is not within the above ratios, this is evidence that additional working capital is needed. Furthermore, when money is borrowed on the fixed assets of an association, the amount borrowed should not exceed 60 percent of the value of the fixed assets. If the borrowings are more than this percentage, the members of the association should acquire a greater equity in their value.

It is also well to keep in mind that a cooperative should never under normal conditions use its full borrowing capacity. There should be a reserve in borrowing capacity to use in emergencies. This principle is often overlooked by both the lender and the cooperative itself and, consequently, when an emergency does arrive, a serious situation sometimes develops.

Guideposts reduce financial difficulties

Many associations have become involved in very difficult financial troubles because they did not set up and follow some definite guideposts, such as the ratios explained above. Some have even gone so far as to endeavor to hide their financial problems from the membership by overstating the value of their assets or failing to report all of their liabilities in their financial statements. Such procedure, of course, adds fuel to the fire and hastens the time when there must be a complete financial reckoning with the membership and new funds must be secured or the association ceases to operate.

It is just good business and a sound financial policy for the board of directors to insist that the various items of assets and liabilities should be stated accurately and conservatively on the balance sheet of the association. This means, of course, that depreciation and bad debts and other losses should be written off currently in order that the true financial condition of the association may be ascertained.

Credit policy may make or break association

Perhaps more cooperative associations have gotten into financial difficulties through their credit policies, if they can be called policies, than through any other one procedure. Whenever the manager of a cooperative extends credit promiscuously to members, the chances are that sooner or later he will find himself with a shortage in working capital which has been frozen in credit accounts, some of which he will never collect.

Ordinarily, the reason for extending credit to members by the manager is for the purpose of increasing his volume of business or to accommodate a member in need, or perhaps to retain the member's business. Seldom does he stop to consider that usually a patron who must be influenced to deliver his products to the association through the process of over-expansion of credit, is hardly worth getting or keeping. The board of directors should be well

aware of the fact that they are not running a banking business and very likely cannot afford to operate on a credit basis.

Members should pay for credit

Extending credit to members is costly and research studies show that the cost of extending credit to members through a cooperative association sometimes runs as high at 10 to 18 percent per year. If the member, who wishes to secure credit through his cooperative, were asked to stand the entire cost of such credit, he undoubtedly would refuse to do so, thinking that it was exorbitant. Yet many members expect and receive credit through their association at no cost to themselves whatsoever. This is unfair to the members who do not borrow through the cooperative, because the earnings of the association and the patronage dividends are lowered because of the credit operations.

Consequently, the directors of the cooperative should definitely decide upon credit policies for their association and then hold the manager responsible for seeing that the policies are kept in effect. This will reduce the possibility of dissipating the working capital and current assets of the association through the extension of credit and through assuming unwarranted credit risks.

If a credit business is done by a cooperative, it should be conducted entirely on a businesslike basis. The credit policy should specify that all credit extended to members should be passed upon by a credit committee after careful investigation and definite plans for repayment have been worked out in advance. Members should always be encouraged and advised to make full use of credit agencies which have been established for the purpose of providing them with the credit necessary to conduct their production operations and meet their financial obligations.

Keep inventory supplies active

Another situation involving the finances of cooperatives, which must be guarded against, is that of overinvestment in inventories. Very often such situations occur with purchasing associations, because purchases of supplies must be made several months in advance of expected sales. Here it is necessary to guard against overstocking on the one hand and an inventory shortage on the other.

Lack of balance in the inventory and lack of adequate control over the items on hand and the quantities needed are also responsible for helping to bring about overinvestments in inventories. Gradual accumulation of large quantities of obsolete or unusable items adds to the situation, whereas the buying of materials during a period of rising prices, which cannot be sold except at a heavy loss when prices abruptly fall, causes even more serious complications. Overinvestments in inventories mean unnecessary costs. Not only do such situations freeze current assets, but the longer an item is carried, the greater the cost becomes because interest accumulates on the investment, and relatively few items improve with age.

Turn-over analysis serves as guide

In order to effectively deal with over-investments in inventories, proper analyses must be made of the situation. The "turn-over analysis method" is a useful device in determining departmental efficiency and in eliminating dead and obsolete inventories. Such an analysis should be made currently as valuable information may be gained from comparative-trend studies of sales, cost-of-goods sold, and inventories. It is also easy to determine from such a method what procedure should be used in correcting past mistakes in making purchases and eliminating similar mistakes in future operations.

Limit fixed assets to needs

Quite frequently, cooperatives also err by making overinvestments in fixed assets. When such a situation occurs, it is generally more dangerous than is overinvestment in inventories or receivables. There is no easy cure for a condition of this kind and it sometimes represents a permanent problem. It generally results from an unsound expansion program in which the directors and the manager overlook the significant fact that no expansion is sound unless the resultant business will take care of the additional expenses involved.

Surplus needs determine tax policy

One other financial problem, which recently has become of increased importance, is that of meeting internal revenue requirements in connection with corporate income taxes. Cooperatives have devised and are using several methods of handling their surpluses in view of the internal revenue requirements. Some cooperatives are following the policy of retaining their earnings as surplus for a few years, paying taxes on it, and then, later, meeting the requirements of the law and applying for exemptions. Others follow the principle that since the law requires cooperatives to pay all of their earnings out in dividends, mostly patronage dividends, in order to secure exemption, that they will meet the requirements of the law in order to eliminate the necessity of paying taxes, even though they never build up any surplus. This is based on the idea that they can maintain working capital by issuing the dividends in stock or certificates of indebtedness. Still other cooperatives take the attitude that it is the best policy to pay most of their earnings out in the form of patronage dividends, but each year add from 10 to 20 percent of their net earnings to surplus and pay the income tax on the amount they have thus added.

In final analysis, perhaps the latter procedure is the most satisfactory

policy to follow. Not only does it build toward a sound financial program for the association, but it results in following the sound cooperative policy of returning unneeded earnings to the members in the form of patronage dividends.

Operating Policies and Problems

Sometimes, too often in fact, operating problems and policies are considered to be the worry of the management whose job it is to solve them and to keep things running smoothly. Quite to the contrary, members should have an important voice in establishing operating policies. The directors should be, and generally are, directed by the wishes of the members, and the manager is guided by the instructions of the directors.

Obviously, therefore, all parties interested in the association have responsibilities in this respect which should be performed both as individuals and on a collective basis. Wherever you find a cooperative association, you will find an organization that has had, and is still faced with, operating problems. Some of these problems have been annoying, others have been troublesome, while still others have been so difficult to handle that they have gone unsolved and finally brought about the failure of the association involved. Let us briefly consider, therefore, some of these operating problems that are of general concern.

Over-advances are dangerous

Closely associated with financial problems is the operating problem which grows out of a policy of over-advances paid to producers for products delivered to the association. Some members and patrons have not been fair at all in dealing with cooperative associations from the standpoint of what they expect to get in the way of advances at the time they deliver the products for sale.

Commonly, a member or patron of an association will call the manager and ask, "What are you paying for wheat, or hogs, or eggs today?" The response of the manager should always be, "We are not buying these commodities, but are handling them for the members and patrons on a cooperative basis." However, this response is not always forthcoming and the reply is made in terms of the amounts the association is willing to advance for the commodity or commodities in question.

Co-op is sales agency

Members should look upon the delivery of their products to the association as but a step toward merchandising and not as a sale. Never should they think of deliveries as selling their products to the association. Actually they are delivering their products to their own business organization and should not expect an advance equal to the price being paid by the independent competitors of the association.

Managers should recognize the dangers in making too high advances for the products which patrons deliver to their associations and, with the help of the board of directors, should do all they can to educate members concerning the difficulties to which such a custom leads. Legally, over-advances can be recovered, but many associations have learned in practice that it is a most difficult thing to accomplish.

Members who demand advances in keeping with competitors buying prices are likely to quit the association if they are able to find a competitor who is willing to pay a higher price then the association sees fit to advance. Consequently, nothing is to be gained and much is to be lost by following a policy of advancing the last cent that can be advanced in handling products for producers.

Keep business volume high

A corollary to the statement that the manager is the "mainspring" of the association is that the volume of business done is the "life blood" of the cooperative. An unsufficient volume of business has been prominent among the causes which have resulted in the failure of cooperatives.

Many reasons have been found why the volume was not sufficient to permit an association to operate successfully. Sometimes, those who have been responsible for organizing a cooperative over-estimate the volume of business which can be obtained and handled through the association. More often, the general withdrawal of members from the cooperative, because of misunderstanding or dissatisfaction, has been the reason for the diminishing volume.

Causes of volume loss

This loss of membership and volume is usually traceable to poor management, insufficient returns for products delivered, or excessive expenditures and handling charges. Sometimes, the falling off of volume can be attributed to competition, unfair competition if you will, for in some instances competitors have set out to over-pay or under-sell the cooperative for the specific purpose of putting it out of business.

In still other instances, changes in the methods of transportation and in communication have been responsible for taking business away from a cooperative where the board of directors and management were not progressive enough to foresee the predicament and had not adjusted their operations to meet the new conditions. Sometimes, a general decrease in production in given areas, resulting from drought or other special circumstances, has affected cooperative organizations and has made it difficult for those who could not make adjustments to meet the new conditions of operation.

Large volume reduces unit costs

As has already been recognized, a substantial volume of business is necessary if a cooperative is to render maximum service to its members at the lowest possible cost. A large volume of business enables a cooperative to employ more competent management, to utilize its facilities to best advantage, and to be more progressive and to obtain greater efficiency in purchasing and in operation. Of course, expenses increase as volume increases, but it is more important to remember that expenses increase at a slower rate because a large portion of the total expenses of a cooperative are usually fixed or semi-fixed in nature.

Efficiency is also important

Many cooperative organizations have increased their volume of business by increasing their efficiency and decreasing handling costs, thereby attracting new members to the association. This has been done through the adoption of new credit policies, increasing the services rendered, and changing some of the methods of operation. Some associations have even found it necessary to hire new managers and elect new members to the board of directors in order to accomplish this objective.

Expenditures may be excessive

Many cooperatives have found, after careful analysis of their situation, that one of the principle reasons why they have met with only mediocre success is because they have had excessive expenses. These excessive expenses or handling costs can grow out of many situations, but only the more common causes will be recognized here.

Some associations have hired too many employees, or employees that were not efficient. In some instances, some of the employees were kept on the payroll only because of relationship to or friendship with the manager or members of the board of directors. In other instances, the amount of money paid for

rentals or leases have been out of proportion to the business done by the association, while interest charges on unused facilities or on facilities that are too elaborate for the type of business engaged in by the association have been burdensome.

Many associations, because of the nature of their business, employ trucks, either to collect commodities for the plant or to make deliveries to members and patrons. In many instances, these trucking costs proved to be entirely too high in relation to the volume of business delivered to the plant. Fuel, light, and power bills have been excessive because of inefficient or careless use on the part of the manager and the plant staff.

Budget control aids management

All of these excessive expenditures can be controlled through budgetary policies and sound management practices. Especially is this true if, when setting up the budgets, the board of directors remembers to be conservative regarding the possibilities of future operations. Consideration should be given to the fact that the volume of business, for one reason or another, may decrease and that other unpredictables are likely to appear in the future which may work to the detriment of the association.

Keep handling margins adequate

Closely related to the problems of excessive expenses is that of handling margins, or the difference between the prices received for the members' commodities and those paid to the members. It is well to keep in mind that the handling margins of any cooperative must be large enough to pay the operating expenses, repay its loans, keep intact its financial structure or improve it, and at the same time return to the members for their products as much or more than competitors pay.

If the cooperative is to be successful, the margin for handling must be sufficient. This does not mean, however, that an exorbitant margin

should be taken to provide readily available cash to meet the fancies of the manager in purchasing unnecessary equipment or otherwise making excessive expenditures. Any margins, charged over and above those necessary to meet the necessary obligations, as outlined above, should be returned to the members at the end of the year in the form of patronage dividends. More often, however, cooperatives have found it more difficult to collect adequate margins than to take abnormally large margins for their services.

Good management may narrow margin needs

Here again, the considerations which make it possible for the manager to operate on a strictly business basis are: Sufficient volume, efficiency of management, and competitive conditions. It almost goes without saying that managers of cooperative associations can reduce the problems of margins considerably if they follow the practices of dropping some of their employees during the slack season, influencing producers to become new members, obtaining maximum efficiency in the handling and processing of members' products, and arranging the accounting system in such a way as to take full advantage of trade discounts, tax exemptions, and other discounts which are customary and in accordance with good business practice.

Aggressive sales program needed

Some cooperatives have not succeeded to the utmost because they have not recognized the fact that an aggressive sales program is the motivating power which makes for the success of the entire business. Cooperative sales programs should be aggressive and fully capable of meeting competition in marketing the products. Weak marketing programs may jeopardize the credit standing of an association and cause its final failure. Furthermore, sales programs should be arranged so as to make returns to the producers for the products delivered to the association within a reasonable time after delivery.

Without an aggressive sales policy, a cooperative becomes a mediocre merchandising organization. This means that aggressive competitors, who devise new ways and means of selling their products more effectively and efficiently, will soon be in a position to persuade some of the members of the cooperative to change their sales outlet. Sometimes, competitors are so successful in this respect that, in only a short time, the cooperative may find itself in difficult circumstances.

Records aid efficiency

Most cooperative organizations in the United States are farmers' organizations, and many farmers look on bookkeeping and accounting only as necessary evils. It is probably fair to say that in most instances they don't realize the importance of this phase of their business because they themselves are not accustomed to keeping proper accounting records and to preparing financial statements. This is perhaps the reason why the farmer directors of a cooperative have not always seen fit to insist on the proper records and audits for the association which they and the membership own and operate. Such instrumentalities, however, are the only way of checking on the business, determining its financial status, determining the cause of losses, and taking the proper steps to stop such losses.

Adequate accounting records and audits are also absolutely essential to present the necessary information to credit agencies as a basis in getting a loan, in making tax returns, or presenting claims for tax exemptions. The importance and need for these documents is gradually being impressed on cooperative board members and management to an increasing degree. In this connection, it should be stated that uniform accounting systems for associations performing similar types of services are most desirable and are being developed, but much work still needs to be done to get more cooperatives to

adapt and put more efficient accounting systems into operation. This is an educational process, not only with the managers but with the boards of directors as well.

Have complete audits regularly

Complete audits should be made at least once each year for any business organization worthy of the name. Some cooperatives have found it not only desirable but practical to have audits prepared three or four times yearly, and some have gone so far as to believe it advisable to spend the money for monthly audits in order to be in a position to be of greater service or to make greater returns to the members. Under all circumstances, audits should be made by a competent auditor who understands the cooperative method of doing business. Furthermore, he should be employed by the board of directors, not by the manager, and therefore should be responsible for reporting directly to the board of directors regarding the financial condition of their association.

Keep co-op property insured

Another operative consideration, which boards of directors sometimes have been rather lax in handling in the past, has been that of protecting members' interest against common hazards. One of the distinct advantages of belonging to a cooperative association is the protection which they expect to get against hazards, such as fires, floods, tornado, and other insurable losses. The proper amount and kinds of insurance should be carried upon all cooperative property, and some associations that employ outstanding managers carry life insurance on them which is payable to the association in case of death. Directors and management do not live up to their obligations to the members or creditors of the association unless protection against loss is provided.

Similarly, a system of adequate internal control, as a guarantee against dishonesty, should be provided. Adequate fidelity and faithful-

performance bonds should be required of all employees who handle cash and other assets of the association. This is not intended to infer that co-operative employees are, as a rule, dishonest. In fact, they are far from it, but taking adequate precautions against the possible exception is only following the policies of sound business, as losses of funds may wreck a cooperative just as quickly as other disasters.

Cooperative important to community

Finally, something should be said about one other operating policy which many times is entirely overlooked by cooperatives. It is simply that the cooperative is a part, and many times a very important part, of the community in which it operates, and therefore has responsibilities to the community which it cannot afford to neglect. This is what might be termed a public relations responsibility, for a cooperative should take part in the community affairs and in progressive community movements for the good of the community and its membership.

In this respect, it should be the objective of the board of directors and the management to keep the general public informed at all times regarding the aims and accomplishments of their association. This tends to secure the friendship and understanding of the community, and no doubt has been responsible in many instances for a gain in the volume of business by the cooperative.

Keep competitors friendly

It is just as important for a cooperative to spare no efforts in developing friendly relations with its competitors. It is much safer, and the cooperative will fare better, if it develops a policy of "live and let live" with its competitors rather than to be instrumental in establishing a system of price cutting which the competitors are almost sure to follow. Instead, let the manager and board of directors think of the association as being a

sound marketing organization and operate it in such a way that they can meet just and reasonable competition and still have something left to distribute in patronage dividends at the end of the year.

Furthermore, it is also a good policy for cooperatives to cooperate with their competitors in solving problems of common interest such as accounts receivable, itinerant truckers, and legislation of interest to the trade.

Finally, the local cooperative should never overlook its obligations and relations to its own central organization, if it has one. Local co-operatives should have an interest in, and feel an obligation in this respect and be willing to do what they can to insure the success of the central or parent organization. They should give it the same support as the locals expect of their members.

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